

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other			Local Government Name Hurley Medical Center	County Genesee
Audit Date June 30, 2004	Opinion Date October 1, 2004	Date Accountant Report Submitted to State:		

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.

2. We are certified public accountants registered to practice in Michigan.

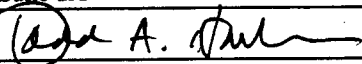
We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ yes ☒ no 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ yes ☒ no 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☐ yes ☒ no 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1-1968, as amended).
- ☐ yes ☒ no 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ yes ☒ no 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ yes ☒ no 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ yes ☒ no 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 1 00% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ yes ☒ no 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ yes ☒ no 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	X		
Reports on individual federal financial assistance programs (program audits).			X
Single Audit Reports (ASLGU).			X

Certified Public Accountant (Firm Name) BKR Dupuis & Ryden			
Street Address 111 E. Court Street, Suite 1A	City Flint	State MI	ZIP 48502
Accountant Signature 		Tadd A. Harburn, CPA	

**Consolidated
Financial Statements
Hurley Medical Center
Flint, Michigan
June 30, 2004 and 2003**

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Independent Auditors' Report

To the Board of Hospital Managers
Hurley Medical Center
Flint, Michigan

We have audited the accompanying consolidated financial statements of the business-type activities of Hurley Medical Center (a component unit of the City of Flint, Michigan) as of June 30, 2004 and 2003, which collectively comprise the Medical Center's basic financial statements as listed in the table of contents. These consolidated financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hurley Medical Center as of June 30, 2004 and 2003, and the results of its consolidated operations, changes in its fund net assets, and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits have been made primarily for the purpose of expressing an opinion on the consolidated financial statements taken as a whole. The accompanying supplementary information is presented for analysis purposes and is not necessary for a fair presentation of the consolidated financial statements. It has been subjected to the tests and other auditing procedures applied in the audits of the consolidated financial statements mentioned above and, in our opinion, is fairly stated in all respects material in relation to the consolidated financial statements taken as a whole.

BKR Dupuis & Ryden

Certified Public Accountants
Flint Office

October 1, 2004

Hurley Medical Center
Management's Discussion and Analysis

GASB No. 34

Hurley Medical Center, as a component unit of the City of Flint, Michigan, has implemented the new Governmental Accounting Standards Board Statement No. 34. As required by GASB No. 34, Hurley Medical Center includes Management's Discussion and Analysis in the annual audit report. This section presents our discussion and analysis of Hurley Medical Center's financial performance during the fiscal year ended June 30, 2004.

Description of Organization

Hurley Medical Center is a 463 bed teaching hospital. It is the sole provider in the region for Level I Trauma services, neonatal intensive care unit, burn unit, pediatric intensive care unit, involuntary mental health unit, and kidney transplant services. Additionally, Hurley has large programs in Obstetrics, Pediatrics, Oncology, Cardiology, and Surgery. As a teaching hospital, Hurley trains over 90 residents annually from both the Michigan State University and University of Michigan Medical Schools. Additionally, Hurley has a joint nursing school with the University of Michigan and several paraprofessional training schools. With over 2,500 employees, Hurley is one of the largest employers in the region.

Financial Statements

This report consists of four parts – Management's Discussion and Analysis (this section), the basic consolidated financial statements, required supplemental information, and an optional section that presents consolidating financial statements.

Included in this report are the following financial statements for Hurley Medical Center and its wholly owned subsidiary, Hurley Health Services:

1. Consolidated Balance Sheets
2. Consolidated Statements of Operations – Unrestricted Fund
3. Consolidated Statements of Changes in Fund Net Assets
4. Consolidated Statements of Cash Flows

Condensed Financial Information

	<u>(In Thousands)</u>	
	<u>6/30/04</u>	<u>6/30/03</u>
Non-capital assets	\$174,579	\$172,966
Capital assets – net	61,880	66,328
Total assets	<u>\$236,459</u>	<u>\$234,372</u>
Current liabilities	\$ 52,163	\$48,906
Long-term liabilities	89,824	93,726
Total liabilities	<u>\$141,986</u>	<u>\$142,632</u>
Net assets	<u>\$ 94,473</u>	<u>\$ 91,740</u>

Condensed Financial Information – (continued)

	<u>(In Thousands)</u>	
	<u>6/30/04</u>	<u>6/30/03</u>
Operating revenues	\$320,836	\$340,667
Operating expenses	<u>321,492</u>	<u>332,483</u>
Operating income (loss)	(656)	8,184
Non-operating revenues (expenses)	<u>3,874</u>	<u>4,238</u>
Excess (deficiency) of revenues over expenses	<u>\$ 3,218</u>	<u>\$ 12,422</u>

Financial Highlights

Hurley Medical Center reported a \$3.2 million net income in fiscal 2004, nearly triple the budgeted \$1.1 million net income. Inpatient discharges grew by 4%, with strong gains in Obstetrics, Neonatal and Bariatric Surgery. Due to divestitures of Home Care and Outpatient Renal Dialysis, patient revenues dropped by 2.7%, however operating expenses dropped by 3.3%.

Continuous revenue cycle improvements from admitting processes to billing and collection gains resulted in a drop in gross accounts receivable from 74.5 to 63.5 days in fiscal 2004. This helped increase unrestricted cash from 57.3 days to 92.0 days.

Significant Transactions

There were no significant transactions during fiscal 2004.

Capital Assets

During fiscal 2004, Hurley Medical Center purchased \$7.3 million of capital assets. The largest items include the first phase of a major laboratory renovation and automation, patient telemetry equipment, anesthesia machines and numerous upgrades of information systems.

Long-Term Debt

No new debt was issued during fiscal 2004 and \$3.2 million of principal was paid on outstanding debt. The remaining proceeds of \$6.2 million of new money from the Series 2003 bonds were used to fund capital purchases.

**Hurley Medical Center
Consolidated Balance Sheets
June 30, 2004 and 2003**

Assets	2004	2003
Current assets:		
Cash and cash equivalents	\$ 33,158,440	\$ 39,930,107
Patient accounts receivable, net	55,902,088	66,279,699
Other receivables	7,900,397	11,967,288
Inventories	3,222,448	3,255,819
Prepaid expenses and other	3,130,259	3,147,921
Assets limited as to use	3,153,535	2,572,387
Total current assets	<u>106,467,167</u>	<u>127,153,221</u>
Assets limited as to use:		
By the Board	45,206,388	12,255,486
Under bond indenture agreement - held by trustee	17,342,320	23,357,753
Restricted	330,589	333,290
Total assets limited as to use	<u>62,879,297</u>	<u>35,946,529</u>
Less assets limited as to use that that are required for current liabilities	<u>(3,153,535)</u>	<u>(2,572,387)</u>
Noncurrent assets whose use is limited	<u>59,725,762</u>	<u>33,374,142</u>
Other assets:		
Defeasance loss, net	1,169,612	1,335,632
Bond issuance costs, net	773,391	836,706
Investment in joint ventures	6,260,988	5,115,716
Subsidiary goodwill, and other	182,264	228,390
Total other assets	<u>8,386,255</u>	<u>7,516,444</u>
Property, plant and equipment, net	<u>61,880,196</u>	<u>66,327,700</u>
	<u><u>\$ 236,459,380</u></u>	<u><u>\$ 234,371,507</u></u>

See notes to consolidated financial statements.

Liabilities and Fund Net Assets**Current liabilities:**

Accounts payable and taxes withheld
Current portion of long-term debt
Accrued expenses

	<u>2004</u>	<u>2003</u>
\$	14,675,412	\$ 16,746,094
	3,407,320	3,184,247
	<u>34,080,218</u>	<u>28,975,317</u>

Total current liabilities

52,162,950 48,905,658

Accrued expenses
Lease obligations, net of current portion
Long-term debt, net of current portion

17,201,050	17,902,711
4,490,805	5,935,238
<u>68,131,939</u>	<u>69,887,877</u>

Total liabilities

141,986,744 142,631,484

Fund Net Assets:

Invested in capital equipment, net of related debt
Unrestricted
Restricted

22,109,685	20,441,358
69,256,426	67,595,434
<u>3,106,525</u>	<u>3,703,231</u>

Total fund net assets

94,472,636 91,740,023

\$ 236,459,380 \$ 234,371,507

Hurley Medical Center
Consolidated Statements of Revenues and Expenses -Unrestricted Fund
For the Years Ended June 30, 2004 and 2003

	2004	2003
Net patient service revenues	\$ 293,637,252	\$ 301,939,155
Other operating revenues	27,171,090	24,892,450
Gain on sale of renal program	-	13,835,320
Total operating revenues	320,808,342	340,666,925
Operating expenses:		
Salaries and wages	136,547,021	134,647,728
Professional services	20,031,877	18,852,407
Payroll taxes and fringes	36,008,815	35,080,394
Supplies	36,215,070	38,903,343
Purchased services and other	49,476,273	55,754,769
Depreciation and amortization expense	11,279,371	12,339,077
Interest expense	4,969,907	3,584,412
Impairment loss on Medicaid HMO receivables	-	4,845,445
Provision for uncollectible accounts	26,964,785	28,475,445
Total operating expenses	321,493,119	332,483,020
Operating profit (loss)	(684,777)	8,183,905
Non-operating revenues:		
Investment income and unrestricted donations	954,706	1,604,614
Joint venture income	2,098,517	486,099
Assets released from restrictions for the purchase of plant and equipment	960,873	2,147,120
Total non-operating revenues	4,014,096	4,237,833
Excess of revenues over expenses	\$ 3,329,319	\$ 12,421,738

See notes to consolidated financial statements.

Hurley Medical Center
Consolidated Statements of Changes in Fund Net Assets
For the Years Ended June 30, 2004 and 2003

	<u>Unrestricted</u> Consolidated General Fund	<u>Restricted Funds</u> Specific Purpose Funds	Totals
Balance at June 30, 2002	\$ 75,615,054	\$ 3,574,245	\$ 79,189,299
Excess of revenues over expenses	12,421,738	-	12,421,738
Restricted gifts and bequests	-	2,637,558	2,637,558
Income from investments	-	72,869	72,869
Transfer of funds:			
To general fund:			
Property, plant, and equipment additions	-	(2,147,120)	(2,147,120)
Other operating revenue (expenses)	-	(434,321)	(434,321)
Balance at June 30, 2003	88,036,792	3,703,231	91,740,023
Excess of revenues over expenses	3,329,319	-	3,329,319
Restricted gifts and bequests		1,424,991	1,424,991
Income from investments		43,467	43,467
Transfer of funds:			
To general fund:			
Property, plant, and equipment additions		(960,873)	(960,873)
Other operating revenue (expenses)		(1,104,291)	(1,104,291)
Balance at June 30, 2004	\$ 91,366,111	\$ 3,106,525	\$ 94,472,636

See notes to consolidated financial statements.

Hurley Medical Center
Consolidated Statements of Cash Flows
For the Years Ended June 30, 2004 and 2003

	2004	2003
Cash flows from operating activities and gains and losses:		
Receipts from patients and insurance companies	\$ 333,000,250	\$ 338,406,004
Payments to vendors	(169,354,752)	(186,261,063)
Payments to employees	(136,547,021)	(134,647,728)
Net cash provided by operating activities	27,098,477	17,497,213
Cash flows from investing activities:		
Distributions from joint ventures	2,721,011	1,765,000
Investment in Joint Venture	(1,742,000)	-
Purchases of assets whose use is limited	(26,996,508)	(543,809)
Purchase of stock certificates	(1,500)	7,500
Payments on notes receivable	24,500	(23,279)
Interest on investments	983,202	1,174,985
Net cash provided by (used in) investing activities	(25,011,295)	2,380,397
Cash flows from non-capital financing activities:		
Net proceeds from contributions restricted for specific expenditures	1,424,991	2,637,558
Joint venture income	19,540	(182,403)
Net cash provided by non-capital financing activities	1,444,531	2,455,155
Cash flows from financing activities:		
Proceeds from note payable and capital lease	-	33,351,804
Repayment of long-term debt and capital lease obligations	(3,196,359)	(30,453,292)
Purchase of property and equipment and software	(7,284,597)	(8,005,046)
Proceeds from sale of assets	177,575	11,960,609
Net cash provided by (used in) financing activities	(10,303,381)	6,854,075
Net increase (decrease) in cash and cash equivalents	(6,771,668)	29,186,840
Cash and cash equivalents at beginning of year	39,930,108	10,743,267
Cash and cash equivalents at end of year	\$ 33,158,440	\$ 39,930,107

See notes to consolidated financial statements.

(continued)

Hurley Medical Center
Consolidated Statements of Cash Flows (continued)
For the Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities and gains and losses:		
Operating income (loss)	\$ (684,777)	\$ 8,183,905
Adjustments to reconcile operating income (loss) to net cash provided by operating activities and gains and losses:		
Depreciation and amortization	11,279,371	12,339,077
Amortization of bond discounts, issuance costs, and other deferred charges	229,335	792,230
Amortization of deferred defeasance gain	219,061	38,078
(Gain) loss on disposal of equipment	292,443	(13,746,513)
Contribution released from restrictions	(1,104,291)	(434,321)
Changes in operating assets and liabilities:		
Patient and other accounts receivable	13,232,459	(1,890,340)
Inventories	33,371	615,575
Prepaid expenses and other	81,106	404,626
Interest receivable on assets whose use is limited	63,740	63,740
Accounts payable and taxes withheld	(823,856)	544,453
Accrued expenses	4,280,515	10,586,703
	<hr/>	<hr/>
Net cash provided by operating activities and gains and losses	<u>\$ 27,098,477</u>	<u>\$ 17,497,213</u>

Supplemental Disclosures of cash flow information:

Cash paid for interest in 2004 and 2003, was \$4,091,502 and \$3,583,732, respectively.

Non-cash transactions:

The Medical Center recorded a decrease in the investment in subsidiary in the amount of \$66,039 for 2004 and an increase of \$386,907 for 2003.

The Medical Center recorded an increase in the investment in joint ventures in the amount of \$1,145,977 and \$688,503 for 2004 and 2003, respectively.

The Medical Center sold its renal program during 2003, \$3 million of the proceeds from this sale was received in the form of a short term receivable.

See notes to consolidated financial statements.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

1. Summary of significant accounting policies

Organization and reporting entity:

Hurley Medical Center (Medical Center) is a component unit of the City of Flint, Michigan. The Medical Center provides inpatient, outpatient, and emergency care services in Genesee and surrounding counties. As an instrumentality of a political subdivision of the State of Michigan, as described in Section 115 of the Internal Revenue Code, the Medical Center is exempt from federal income taxes.

The City of Flint Hospital Building Authority (the Authority) is a blended component unit of the Medical Center and the City of Flint. The Authority only serves the Medical Center by facilitating the issuance of debt for certain capital improvements and equipment via a lease contract. In accordance with generally accepted accounting principles, the lease transactions between the Medical Center's and the Authority have been eliminated and all debt and related assets have been recorded in the Medical Center's financial statements.

Hurley Health Services (HHS), a municipal support organization, is a wholly owned subsidiary of the Medical Center. HHS on a consolidated basis, is comprised of two non-profit entities (HHS and The Hurley Clinics) and one "for profit" corporation (Hurley Practice Management Services). HHS began operations January 1, 1997.

The consolidated financial statements presented represent the Medical Center and its subsidiary Hurley Health Services, Inc. All intercompany entries have been eliminated.

Proprietary fund accounting:

The Medical Center utilizes the proprietary fund method of accounting whereby, revenues and expenses are recognized on the accrual basis. The proprietary funds apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case GASB prevails.

Cash and cash equivalents:

Cash and cash equivalents include investments in highly liquid, debt instruments with a maturity of three months or less, excluding amounts whose use is limited by board designation or other arrangements under trust agreements or with third-party payors.

Assets limited as to use:

Assets limited as to use include:

- Assets set aside by the Board of Managers for identified purposes, over which the Board retains control, and may at its discretion subsequently use for other purposes.
- Proceeds of debt issues and funds of the Medical Center deposited with a trustee and limited to use in accordance with the requirements of a bond indenture.
- Assets restricted by outside donors.

Investments and investment income:

The Medical Center accounts for its investments in accordance with GASB No. 31, *Accounting for Certain Investments and for External Investment Pools*. All investments are valued at their fair values in the balance sheet except money market investments and interest earning investment contracts that have a remaining maturity of less than one year at the time of purchase. Unrealized gains and losses are included in the statement of operations as non-operating revenues - investment income.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

1. Summary of significant accounting policies - (continued)

Investments and investment income: - (continued)

Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, and investment income on assets deposited in the malpractice trust are reported as operating revenues - other revenue. Investment income from all other general fund investments and investment income of endowment funds are reported as non-operating revenue. Investment income and gains (losses) on investments of donor-restricted funds are added to (deducted from) the appropriate restricted fund balance.

The investment in Hurley Health Services, Inc. (Subsidiary) and other joint ventures are recorded on the equity method of accounting.

Financial statement presentation:

In 2002, the Medical Center adopted GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*. Under GASB 34, the Medical Center is classified as a special purpose government and is required to present statements required for enterprise funds.

Inventories:

Inventories are stated at the lower of cost (first-in, first-out) or market.

Bond issuance cost:

Costs related to the issuance of bonds are deferred and amortized over the life of the bonds. Costs amortized during periods of construction are added to the cost of the related projects.

Deferred defeasance loss (gain):

The defeasance loss (gain) associated with defeased debt is capitalized and amortized over the life of the new debt.

Property, plant, and equipment:

Property, plant, and equipment are stated at cost and depreciated over the estimated useful lives of the related assets. Prior to 1997, the Medical Center utilized an accelerated method of depreciation for substantially all assets. In 1997, the Medical Center switched to straight-line depreciation for all new acquisitions.

In 2003, the software licenses were reclassified to the property, plant, and equipment section.

Sick leave benefits:

Employees of Hurley Medical Center generally are eligible for receiving a portion of unused sick leave benefits only upon retirement, death, or duty-related disability. The Medical Center's policy is to recognize these sick leave benefits at the time an employee becomes vested for retirement or duty-related disability, or in the case of death.

Certain employee groups, however, are eligible to receive a portion of unused sick leave benefits on an annual basis. Hurley Medical Center's policy is to accrue such unpaid sick leave benefits as they are earned.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

1. Summary of significant accounting policies - (continued)

Restricted funds:

Restricted funds are used to differentiate funds, the use of which is limited by the donor from funds on which the donor places no restriction, or which arise as a result of the operation of the Medical Center for its stated purposes.

Net patient service revenue:

Net patient service revenue is reported at the estimated net realizable amounts from patients and third-party payors for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Approximately 53% and 54% of the Medical Center's revenues are based on participation in the Blue Cross Blue Shield, Medicare, and Medicaid programs for the years 2004 and 2003, respectively.

Charity care:

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Estimated malpractice costs:

The provision for estimated self-insured medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The estimate for claims incurred but not reported is based on an actuarial determination.

Interest expense:

Interest expense is charged to operations as incurred, except that interest on funds borrowed for major construction projects, which is capitalized as a component of the cost of the related projects during the period that the borrowed funds are owed.

Income taxes:

The Medical Center and HHS are exempt from income taxes except for HHS's subsidiary, Hurley Practice Management Services. A provision for income taxes (at statutory rates) has been provided for in the consolidated financial statements related to this entity's transactions. The amount of the income tax provision is \$(47,103) and \$127,260, for 2004 and 2003, respectively and is included in "payroll taxes and fringes" line item. Hurley Practice Management Services (HPMS), adopted Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes*, which requires an asset and liability approach to financial accounting and reporting for income taxes. The difference between the financial statement and tax basis of assets and liabilities is determined annually. Deferred income tax assets and liabilities are computed for those differences that have future tax consequences using the current enacted tax laws and rates that apply to the periods in which they are expected to affect taxable income. Valuation allowances are established, if necessary, to reduce the deferred tax asset to the amount that will more likely than not be realized. Income tax expense is the current tax payable or refundable for the period plus or minus the net change in the deferred tax assets and liabilities.

Non-operating revenues and expenses:

The Medical Center categorizes joint ventures, investment income and operations that the Medical Center does not directly oversee as non-operating activities.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

1. Summary of significant accounting policies - (continued)

Estimates:

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Charity care

The Medical Center maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy, the estimated cost of those services and supplies, and equivalent service statistics. The following information measures the level of charity care provided during the years ended June 30, 2004 and 2003.

	<u>2004</u>	<u>2003</u>
Charges foregone, based on established rates	<u>\$598,090</u>	<u>\$1,871,266</u>
Estimated costs and expenses incurred to provide charity care	<u>\$289,029</u>	<u>\$1,032,277</u>
Equivalent percentage of charity care patients to all patients served	<u>.09%</u>	<u>.33%</u>

3. Patient accounts receivable

Patient accounts receivable at June 30, 2004 and 2003, and revenues for the years then ended include estimated amounts due from various third-party payors which are computed in accordance with their respective reimbursement formulas.

Adjustments made by third-party payors upon settlement of prior-year cost reports are included in the statement of revenues and expenses in the year such adjustments become known. As a result of such adjustments, net patient service revenues were increased (decreased) by approximately \$(1,534,029) in 2004 and \$435,234 in 2003.

In addition, the Medical Center has established an estimated allowance for uncollectible accounts of approximately \$26,900,000 and \$29,900,000 for 2004 and 2003, respectively.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

4. Assets limited as to use

Assets limited as to use that are required for obligations classified as current liabilities are reported in current assets. Assets limited as to use at June 30, 2004 and 2003, consisted of the following:

	<u>2004</u>	<u>2003</u>
By Board for funded depreciation and capital improvements:		
Cash and cash equivalents	\$ 8,112,906	\$3,568,415
U.S. Government Securities (cost was \$30,700,558 and \$2,265,377 for 2004 and 2003, respectively)	30,141,291	2,297,086
Accrued interest receivable	58,460	29,337
	<u>38,312,657</u>	<u>5,894,838</u>
By Board for self-insurance:		
Cash and cash equivalents	100,350	60,236
U.S. Government Securities (cost was \$2,303,961 and \$1,994,896 for 2004 and 2003, respectively)	2,288,061	2,041,460
Mutual funds (cost was \$3,758,374 and \$4,232,512 for 2004 and 2003, respectively)	4,475,203	4,222,259
Accrued interest receivable	30,117	36,693
	<u>6,893,731</u>	<u>6,360,648</u>
Total Board designated	<u>\$45,206,388</u>	<u>\$12,255,486</u>
Under bond indenture agreement - held by trustee:		
Cash and cash equivalents	\$14,382,932	\$20,264,730
U.S. Government Securities (cost was \$2,881,614 and \$3,003,300 for 2004 and 2003, respectively)	2,954,829	3,005,859
Accrued interest receivable	4,559	87,164
	<u>\$17,342,320</u>	<u>\$23,357,753</u>
Restricted:		
Cash and cash equivalents	<u>\$ 330,589</u>	<u>\$ 333,290</u>

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

5. Lease purchase commitments and long-term debt

	<u>2004</u>	<u>2003</u>
Lease purchase contract, revenue refunding bonds, Series 1995A, with annual payments ranging from \$2,275,000 in 2000 to \$1,130,000 in 2007, plus interest at 5.25% to 7.00% through 2007.	\$ 3,205,000	\$4,160,000
Lease purchase contract, revenue refunding bonds, Series 1998A, with annual payments ranging from \$485,000 in 2000 to \$1,315,000 in 2021, plus interest at 4% to 5.375% through 2021.	15,290,000	15,845,000
Lease purchase contract, revenue refunding bonds, Series 1998B, with annual payments ranging from \$335,000 in 2000 to \$1,320,000 in 2029, plus interest at 4% to 5.375% through 2029.	18,895,000	19,260,000
Lease purchase contract, revenue refunding bonds, Series 2004, with annual payments ranging from \$1,680,000 in 2008 to \$3,550,000 in 2021, plus interest at 6.00% to 6.50% through 2021.	<u>35,000,000</u>	<u>35,000,000</u>
	72,390,000	74,265,000
Less unamortized bond discount	<u>2,283,061</u>	<u>2,502,123</u>
	70,106,939	71,762,877
Less current portion	<u>1,975,000</u>	<u>1,875,000</u>
	<u>\$68,131,939</u>	<u>\$69,887,877</u>

Aggregate maturities for the five succeeding fiscal years ending June 30, are as follows: 2005 - \$1,975,000; 2006 - \$2,090,000; 2007 - \$2,195,000; 2008 - \$2,795,000; 2009 - \$2,950,000; and 2010 after \$60,385,000.

The prime rate at June 30, 2004 was 4.0%.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

5. Lease purchase commitments and long-term debt - (continued)

The variable rate demand revenue rental and the revenue refunding bonds are payable from the revenues of the Medical Center pursuant to lease/purchase agreements between the Medical Center and the City of Flint Building Authority (the Authority). Under terms of the lease/purchase agreements, the Medical Center has transferred title to substantially all of its facilities to the Authority and leases such facilities from the Authority. Ownership of the facilities reverts to the Medical Center upon payment of the bonds. Rental payments to the Authority are equal to the amounts required to make principal and interest payments on the bonds.

The net revenues of the Medical Center are pledged for payment of principal and interest on the variable rate demand revenue rental and revenue refunding bonds. Accordingly, the consolidated financial statements of the Medical Center include the facilities as if owned by the Medical Center and the bonds as if issued by the Medical Center.

In June 2003, the Medical Center issued Series 2003 revenue refunding bonds for \$35 million. Using the proceeds from this issuance the 1995 B bonds were retired. The 1997 A bonds were also retired in June 2003 using other operating cash of the Medical Center.

The lease purchase agreements contain restrictive covenants which have been met in 2004.

6. Retirement plans

The most recent actuarial valuation providing the disclosures in accordance with Statement No. 25 and 27 is as of December 31, 2002. Significant details regarding the Medical Center's retirement plans are presented below:

Description of plans:

The Medical Center contributes to the City of Flint Employees Retirement System, which is a Single-Employer Public Employee Retirement System (PERS). It is the responsibility of the City of Flint PERS to function as an investment and administrative agent for the Medical Center with respect to the pension plans. The City of Flint PERS is administered by a board of trustees. Investments of the City of Flint PERS are made through Bank One Trust Department and the Northern Trust Company.

The Medical Center has three plan options covering substantially all employees of the Medical Center. The basic plan option, which is the Old Contributory Pension Plan (OCP), provides for employer contributions, as well as requiring employee contributions based upon a percent of pay. Benefits fully vest after 15 years of service or at age 55 with 10 years of service. Under the OCP, employees may retire any time after completion of 25 years of credited service or at age 55 with 10 years of credited service. The lifetime monthly retirement benefit under the OCP is the participant's final average compensation (which is the average of the highest five out of the last ten years of credited service) times 2% of the first 25 years of credited service and 1% for every year thereafter.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

6. Retirement plans – (continued)

Description of plans: - (continued)

A second plan option is the Modified Contributory Pension Plan (MCP) which provides for employer contributions, as well as requiring employee contributions, based upon a percent of pay, but at rates higher than those required under the OCPP. Benefits fully vest after 15 years of service or at age 55 with 10 years of service. Employees may retire any time after completion of 25 years of credited service or at age 55 with 10 years of credited service. The lifetime monthly retirement benefit under the MCP is the participant's final average compensation (which is the average of the highest three out of the last five years of credited service) times 2% of the first 15 years of credited service, plus 2.2% of the next 10 years of credited service, and 1% of every year of credited service beyond year 25.

A third plan option is the Hurley Alternative Pension Plan (HAPP) which provides for only an employer contribution and no employee contribution. Benefits fully vest after 10 years of credited service and a normal retirement age of 60. There are provisions for early retirement at age 55 with a reduced benefit (based upon actuarial assumptions to reflect the additional years of benefit payments). The lifetime monthly retirement benefit under the HAPP is the participant's final average compensation (which is the average of the highest five out of the last ten years of credited service) times 1.5% for all years of credited service.

Benefit provisions are authorized by contract.

Non-exempt employees (members of bargaining units) may participate in either the MCP or the HAPP. Exempt employees may participate in only one of any of the three plans (MCP, HAPP, or OCPP).

The PERS issues a separate financial report which can be obtained from the Pension and Payroll Department at City Hall – City of Flint, Michigan.

Funding policy:

Employee contributions –

	<u>Exempt</u>	<u>Non-exempt</u>
OCPP	3.75% of first \$4,200 of compensation 5.75% on compensation over \$4,200	Not eligible
MCP	4.5% of first \$4,200 of compensation plus 6.5% of compensation over \$4,200	7% of pay
HAPP	None	None

The Medical Center makes employer contributions in accordance with funding requirements determined by an independent actuary. If a member leaves service, he or she may withdraw his or her employee contributions together with interest.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

6. Retirement plans – (continued)

Actuarial assumptions:

The information presented in the required supplementary schedules was determined as a part of the actuarial valuation made at December 31, 2002.

Valuation date	December 31, 2002
Actuarial cost method	Individual Entry Age
Amortization method	Level percent
Remaining amortization period	30 years for unfunded actuarial accrued liabilities
	10 years for valuation assets in excess of actuarial accrued liabilities
Asset valuation method	4 year smoothed market
Actuarial assumption:	
Investment rate of return	7.75%
Projected salary increases	3.95% - 7.55%
Includes wages inflation at	3.75%
Cost of living adjustments	None

Annual required contributions rates:

	<u>Year Ended June 30,</u>		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
Annual Required Contribution (ARC) rate as a percent of covered payroll	0.0%	0.0%	0.0%
Contributions made	0.0%	0.0%	0.0%
Annual pension costs – for year ended	\$ -	\$ -	\$ -
Contributions made – for year ended	-	-	-

The net pension obligation at June 30, 2004 and 2003 was \$-0-.

Profit Sharing and 403(b) Retirement Plan

The HHS has a qualified 401(k) profit sharing plan for HPMS employees. Eligible employees, those that have attained the age of 21 and completed 90 days of service, may defer up to fifteen percent (15%) of their salary. The HHS may make a discretionary contribution. HHS contributions to the 401(k) plan were \$28,230 and \$27,068 for 2004 and 2003, respectively. The HHS also maintains two tax deferred annuity plans under section 403(b) of the Internal Revenue codes. Under the plans, HHS and THC employees may elect to defer up to a percentage of their salary, subject to the Internal Revenue Service limits. HHS may make a discretionary contribution. HHS's contributions to the 403(b) plans amounted to \$342,059 and \$392,013 for 2004 and 2003, respectively.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

7. Leases

Hurley Medical Center and Hurley Health Services lease office space under various operating leases. Certain operating leases contain rental escalation clauses that are based on prime rate at a future date and purchase options at fair market value. The following is a schedule, by year, of future minimum rental payments required under noncancellable operating leases as of June 30, 2004:

2005	\$ 2,109,514
2006	2,080,911
2007	1,927,389
2008	1,623,786
2009	1,443,369
2010 and after	<u>3,121,070</u>
Total minimum payments required	<u>\$12,306,039</u>

Rental expense for all operating leases for the years ended June 30, 2004 and 2003, amounted to \$5,023,129 and \$5,074,040, respectively.

8. Lease obligations

The Medical Center has a capital lease agreement for equipment expiring in 2008. The equipment has been capitalized and the related obligation recorded using the interest rate implicit in the lease. The asset is being depreciated over its useful life. The amount of assets under the capital lease was \$503,981 and the related accumulated depreciation was \$157,194 and \$50,398 at June 30, 2004 and 2003, respectively.

The Medical Center also has two sale-leaseback agreements with a bank for equipment expiring in 2008 and 2009. The equipment has been capitalized and the related obligation recorded using the interest rate implicit in the lease. The assets are being depreciated over their useful lives. The sale-leaseback agreements contain restrictive covenants containing minimum cash flow minimum total and pledged liquid assets, minimum unrestricted net assets, and maximum liabilities to net asset ratio requirements. The Medical Center was in compliance with the covenants.

The following is a reconciliation of the future minimum lease payments to the recorded liability at June 30, 2004:

2005	\$1,681,593
2006	1,693,972
2007	1,693,948
2008	1,348,524
2009	<u>75,940</u>
Total future minimum payments	6,493,977
Less amount representing interest	<u>570,852</u>
Total obligation under capital leases	5,923,125
Less current portion	<u>1,432,320</u>
Long-term obligation under capital leases	<u>\$4,490,805</u>

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

9. Hill-Burton allowance

The provisions for the Hill-Burton allowance, aggregating \$97,006 and \$1,662,008 in the years ended June 30, 2004 and 2003, respectively, are included in the statements of revenues and expenses as a reduction of patient service revenue.

10. Contingencies

Malpractice claims have been asserted against the Medical Center by various claimants. The claims are in various stages of processing, including some that have been brought to trial. Counsel is unable to conclude about the ultimate outcome of the actions, however, it is probable that certain actions will result in unfavorable settlements for the Medical Center. There also are known incidents occurring through June 30, 2004 that may result in the assertion of additional claims. Management is of the opinion that the settlement of those claims probable of unfavorable outcome, as well as the settlement, if any, of such other asserted and unasserted claims, are within the self-insurance limits. Consequently, management believes that such settlements will not significantly affect the Medical Center's financial results. The Medical Center maintains an irrevocable trust to be used for the payment of settlements. The Medical Center funds the trust based upon an annual actuarial determination. The Medical Center purchased a stop loss insurance policy relating to malpractice claims, which will limit the future claims that will be paid from the irrevocable trust.

There are various legal actions pending against Hurley Health Services, its subsidiaries, and certain employees. Due to the inconclusive nature of these actions, it is not possible for legal counsel of Hurley Health Services to determine in the aggregate either the probable outcome of these actions or a reasonable estimate of Hurley Health Services ultimate liability, if any. Hurley Health Services maintains what it believes to be adequate coverage of malpractice, errors and omissions, and directors and officers insurances to cover any possible claims.

11. Post-retirement health care benefits

Effective for retirements on or after July 1, 1983, Hurley Medical Center provides a portion of health insurance premiums for retired employees. The insurance premium for retired employees ranges from \$168 to \$1,499 per month to age 65 and a Medicare supplement after age 65. Retired exempt employees receive full coverage at no cost to the retiree. Retired non-exempt employees pay the full amount or a portion of the premium. No payment is made if the retired employee is covered under other employment. The estimated cost of such benefits is accrued based on a level percent of payroll. Accrued costs charged to expense was \$3,060,050 and \$3,048,779 in the years ended June 30, 2004 and 2003, respectively. The number of participants eligible to receive benefits were 617 and 664 in the years ended June 30, 2004 and 2003, respectively. The Medical Center maintains a trust to be used for payment of the Center's portion of health insurance premiums for retired employees.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

12. Income taxes

The Hurley Practice Management Services' income tax expense differed from the statutory federal rate as follows:

	<u>2004</u>	<u>2003</u>
Statutory rate applied to earnings before:		
Income taxes	\$ (26,977)	\$202,784
Deferred tax liability	(18,317)	93,004
Increase (decrease) in income taxes resulting from:		
Permanent differences	1,131	314
Timing differences	5,812	(85,253)
Benefit of net operating loss carryforward (back)	<u>(8,752)</u>	<u>(117,845)</u>
Income tax expense	<u>\$ (47,103)</u>	<u>\$ 93,004</u>

The components of income taxes related to continuing operations are as follows:

Federal:		
Change in deferred tax asset	\$ (18,317)	\$ 93,004
Federal income tax (refundable) payable	<u>(28,786)</u>	<u>34,256</u>
	<u>\$ (47,103)</u>	<u>\$127,260</u>

The net deferred tax asset in the accompanying balance sheet is entirely classified as current. A valuation allowance is deemed not to be required at June 30, 2004.

The deferred tax asset results primarily from temporary differences in expenses deductible for book purposes versus tax purposes and net operating loss carryforwards.

13. Change in presentation

Prior year numbers have been reclassified to conform to current year presentation.

14. Other

Prior to 1993, the Medical Center was classified under the jurisdiction of the Financial Accounting Standards Board (FASB) and the consolidated financial statements and related disclosures were in compliance with FASB requirements. In January 1993, the Accounting Standards Board issued Statements of Auditing Standard No. 69 *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles(GAAP)."* This statement revised the GAAP Hierarchy which is the auditor's uniform standard for judging the fairness of the overall presentation of the consolidated financial statements. As a result of the issuance of SAS 69, all governmental entities and component units thereof are to be classified under the jurisdiction of the Governmental Accounting Standard Board (GASB).

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

14. Other – (continued)

The Medical Center's disclosures 1-12 remained similar to the prior year to maintain the comparability of the Medical Center to the health care industry. The following are the additional disclosures required by the GASB:

Deposits:

The Medical Center's deposits consist of checking and savings accounts, a certificate of deposit, and money market funds. Deposits are recorded on the consolidated financial statements as cash and cash equivalents. At year end, the carrying amount of the Medical Center's deposits was \$13,034,860 (excluding petty cash of \$11,210), and the bank balance was \$13,487,669. Of the bank balance, \$855,921 was covered by federal depository insurance. The bank balance includes \$8,216,376 of money market funds that are collateralized by securities not in the name of the Medical Center. The rest of the bank balance, or \$4,417,372, was not insured or collateralized.

Investments:

Hurley Medical Center has adopted an investment policy for unrestricted funds that is consistent with the state statutes policy for governmental entities. The unrestricted funds include investments of funded depreciation, malpractice trust, and bond indenture trusts. The state statutes policy authorizes the Medical Center to invest in obligations of the U.S. Treasury and obligations of U.S. agencies, where the principal and interest are fully guaranteed by the United States, deposit agreements with federally insured financial institutions within the State of Michigan, high grade commercial paper, repurchase obligations of the U.S. Government and U.S. agencies, banker's acceptance of U.S. banks, and mutual funds comprised of the above authorized investments. Investments in retired health insurance are not covered by this investment policy and therefore are not restricted.

The Medical Center's investments are as follows:

	<u>Carrying and Market Value Amounts</u>	
	<u>2004</u>	<u>2003</u>
Money market funds	\$12,636,932	\$20,264,730
Repurchase agreements (checking/sweep accounts)		
uninsured, registered collateral held by the		
bank's agent not in the Medical Center's name	30,402,221	35,623,351
U.S. Gov't. securities - insured or registered		
held by a custodial agent in the		
Medical Center's name	<u>35,384,181</u>	<u>7,344,405</u>
Total categorized investments	78,423,334	63,232,486
Governmental security and mutual funds	<u>4,475,203</u>	<u>4,222,259</u>
Total investments	<u>\$82,898,537</u>	<u>\$67,454,745</u>

The Medical Center's investments in mutual funds and pooled governmental securities are not categorized because they are not evidenced by securities that exist in physical or book entry form.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

14. Other – (continued)

Long-term debt:

Changes in the Medical Center's long-term debt (which is detailed in Note 5) is as follows:

	Long-Term Debt (Including Current Portion)	Lease Obligations (Including Current Portion)
Liability at June 30, 2003	\$71,762,877	\$ 7,244,485
Additions:		
Amortization of bond discount	219,062	-
Reductions:		
Payments	<u>(1,875,000)</u>	<u>(1,321,360)</u>
Liability at June 30, 2004	<u>\$70,106,939</u>	<u>\$ 5,923,125</u>

Deferred compensation:

The Medical Center offers a deferred compensation plan adopted in accordance with Internal Revenue Code Section 457A. The plan, available to substantially all employees, permits employees to defer a portion (i.e. the lesser of 100% of their total compensation, or \$13,000) of their current salary until future years. The deferred compensation is not available to the employees until termination, retirement, death, or unforeseeable emergency.

The Plan investments have been placed into a qualified trust to shield the plan investments from the general creditors of a public corporation.

15. Self insurance

Hurley Medical Center is self insured for its hospital professional and patient general liability exposures. The Medical Center has established a self-insurance trust to assist in accumulating resources to fund excess insurance premiums and to pay claims.

The Medical Center's self insured retention is \$5 million per occurrence/\$5 million annual aggregate with excess claims made coverage of \$10 million per occurrence/\$10 million annual aggregate. Claims in excess of \$15 million are to be covered by the Medical Center. The Medical Center employs the use of an actuary to provide an analysis of the existing claims and to estimate the liability for incurred but not reported (IBNR) claims.

The carrying amount of liabilities for unpaid claims amounted to \$21,545,354 and \$19,553,190 at June 30, 2004 and 2003, respectively.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

15. Self insurance – (continued)

The following represents the change in the aggregate liabilities for claims and defense costs payable for the years ended June 30, 2004 and 2003:

	<u>Claims and Defense Costs Payable</u>	
	<u>2004</u>	<u>2003</u>
Balance - beginning of year	\$19,553,190	\$10,621,356
Claims paid	(3,621,133)	(1,505,693)
Defense costs and other fund expenses	(2,365,278)	(2,369,834)
Excess insurance premium payments	(1,618,639)	(1,291,934)
Increase in claims liability	<u>9,597,214</u>	<u>14,099,295</u>
Balance - end of year	<u>\$21,545,354</u>	<u>\$19,553,190</u>
Insurance Trust assets (at market) - end of year	<u>\$ 2,311,714</u>	<u>\$ 1,975,065</u>

The Medical Center is self insured for workers' compensation claims. The Medical Center is on a pay-as-you-go basis. Current claims expense for the year ended June 30, 2004 and 2003 was \$1,331,937 and \$1,180,986, respectively.

16. Joint ventures

Hurley Medical Center participates in six privately held joint ventures, Greater Flint Area Hospital Imaging Center, Inc., (GFAHIC), Flint Health Systems Imaging Center, Inc., (FHSIC), HGH, Inc., (HealthPlus Partners), Hurley PHO of Mid-Michigan, Michigan Lithotripsy Network and Genesys Hurley Cancer Institute. Each corporate joint venture is recorded in the financial statements in accordance with Accounting Principles Board Statement 18 on the equity method of accounting.

GFAHIC and FHSIC provides magnetic resonance imaging (MRI) services to the Greater Flint and Genesee County community. The ownership of both Corporations is allocated between Hurley Medical Center, Genesys Regional Medical Center, and McLaren Regional Medical Center. The joint venture provides that each participant shares in the annual earnings/loss of the Corporations. The net investment by the Medical Center at June 30, 2004 and 2003 was \$2,994,888 and \$3,342,496, respectively. A total of \$2,675,000 and \$1,500,000 was distributed to the Medical Center during the year ended June 30, 2004 and 2003, respectively.

HGH, Inc., is a joint venture among Hurley Medical Center, HealthPlus of Michigan, Inc., Genesys Regional Medical Center and Memorial Health Care Center. During 2004, Memorial Health Care Center withdrew from the joint venture and the remaining three entities contributed capital of \$1,742,000 each to the venture. The venture was established during 1995 to provide a methodology to enroll Medicaid patients in the statewide managed care initiative for Medicaid. The Medical Center's net investment was \$(425,040) and \$(1,395,483) at June 30, 2004 and 2003, respectively. The arrangement provides that the three entities will share in the excess revenues or expenditures of the joint venture.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

16. Joint ventures – (continued)

Hurley PHO of Mid-Michigan is a joint venture between Hurley Medical Center and its medical staff. The venture was established during 1997 to provide vertically integrated continuous care which will facilitate the Medical Center participating in managed care contracts in the future. The Medical Center's net investment at June 30, 2004 and 2003 was \$541,840 and \$616,494, respectively. The arrangement provides that the Medical Center will be allocated 50 percent in excess revenues or expenditures of the joint venture.

Michigan Lithotripsy Network is a joint venture between Hurley Medical Center and six other hospitals. The venture was established during 1999 to provide a mobile lithotripsy unit to be utilized by the participating hospitals. The Medical Center's net investment at June 30, 2004 and 2003 was \$54,432 and \$77,005, respectively. The arrangement provides that the seven hospitals will share equally in the excess revenues or expenditures of the joint venture.

Genesys Hurley Cancer Institute is a joint venture between Hurley Medical Center and Genesys Regional Medical Center. The venture was established during 2001, to provide outpatient oncology services, including laboratory, and radiation oncology. The Medical Centers net investment at June 30, 2004 and 2003 was \$1,330,333 and \$709,964 respectively. The arrangement provides that the two entities will share equally in the excess revenues or expenditures of the joint venture.

The financial statements of each entity are available at the Medical Center's administrative office.

17. Subsequent events

A. Interest rate swap

On July 1, 2004, Hurley Medical Center entered into an interest rate swap agreement with Piper Jaffray related to the \$35 million bond issue that changed interest to be paid from a fixed rate of 5.69% to a variable rate of 3.3%. The term of the agreement is seven years but can be terminated at any time.

B. City of Flint Public Employer Retirement System (City of Flint PERS)

During the fiscal year ended June 30, 2004, seven of nine employee unions plus the exempt employees voted to change participation from the City of Flint PERS to the Michigan Municipal Public Employees Retirement System (MERS). The process to effectuate the transfer is in process at June 30, 2004. Formal transfer is expected in mid fiscal year 2005. Employer contribution rates of the MERS plan are expected not to be greater than those of the City of Flint PERS.

Hurley Medical Center
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

17. Property, plant and equipment and depreciation

Property, plant and equipment and the related accumulated depreciation are summarized by categories as follows:

	<u>Property, Plant and Equipment</u>			<u>Accumulated Depreciation</u>		
	<u>June 30, 2003</u>	<u>Additions, at Cost</u>	<u>Transfers/ Retirements</u>	<u>June 30, 2004</u>	<u>Depreciation Charged to Expense</u>	<u>June 30, 2004</u>
Hurley Medical Center:						
Land	\$ 3,667,589	\$ -	\$ -	\$ 3,667,589	\$ -	\$ -
Land improvements	3,852,985	-	-	3,852,985	91,100	3,487,163
Buildings:						
Medical center building	105,044,698	839,263	(536,479)	105,347,482	3,492,499	82,107,190
Parking structure	2,527,293	-	-	2,527,293	90,546	2,159,781
Nurses' residence	1,520,413	-	-	1,520,413	17,952	1,336,027
Interns' apartment	303,482	-	-	303,482	4,051	274,966
Prospect street apartments	1,253,073	-	-	1,253,073	24,869	1,140,075
Power plant	2,350,495	-	-	2,350,495	118,439	1,698,797
Rental property	350,497	-	-	350,497	3,875	335,381
Health and fitness center	4,565,319	-	-	4,565,319	209,923	3,242,989
Park Plaza	1,258,501	-	-	1,258,501	62,215	906,511
Physicians' office building	329,816	-	-	329,816	17,471	218,388
Northpointe Clinic	1,778,012	-	-	1,778,012	56,794	406,569
Davison Clinic	1,901,857	-	-	1,901,857	55,823	378,202
Longway Eastside Campus bldg.	4,027,518	-	-	4,027,518	141,353	517,459
Total buildings	127,210,974	839,263	(536,479)	127,513,758	4,295,810	94,722,335
Machinery and equipment	93,914,689	6,104,071	(5,913,297)	94,105,463	6,644,647	72,422,087
Automotive equipment	377,101	19,806	(33,436)	363,471	24,891	289,518
Construction in progress	1,320,031	7,270,301	(6,963,140)	1,627,192	-	-
Total Hurley Medical Center	230,343,369	14,233,441	(13,446,352)	231,130,458	11,056,448	170,921,103
Hurley Health Services:						
Leasehold improvements	1,295,224	-	(9,984)	1,285,240	40,927	269,636
Equipment and furnishings	2,202,344	14,493	(129,602)	2,087,237	176,956	1,432,000
Total Hurley Health Services	3,497,568	14,493	(139,586)	3,372,477	217,883	1,701,636
Grand total	\$233,840,937	\$14,247,934	\$(13,585,938)	\$234,502,935	\$11,274,331	\$172,622,739

Required Supplementary Information

Hurley Medical Center Division
City of Flint Employees Retirement System
Required Supplementary Information
Analysis of Funding Progress

Plan Year <u>End</u>	Actuarial Valuation <u>Date</u>	Actuarial Value of Assets <u>(a)</u>	Actuarial Accrued Liability Attained Age <u>(AAL)(b)</u>	(Unfunded) Over Funded AAL <u>(a - b)</u>	Funded Ratio <u>(a/b)</u>	Covered Payroll <u>(c)</u>	(UAAL) as % of Payroll <u>(b - a)(c)</u>
6-30-97	12-31-95	\$238,204,021	\$220,503,557	\$17,700,464	108.0%	\$87,333,791	0.0%
6-30-98	12-31-96	257,531,709	242,476,930	15,054,779	106.2	83,112,658	0.0
6-30-99	12-31-97	301,060,938	259,985,429	41,075,509	115.8	87,651,874	0.0
6-30-00	12-31-98	322,497,186	281,563,941	40,933,239	112.7	96,417,303	0.0
6-30-01	12-31-99	340,608,779	306,134,487	34,474,292	111.3	107,246,608	0.0
6-30-02	12-31-00	354,306,658	328,489,881	25,816,777	107.9	105,102,019	0.0
6-30-03	12-31-01	367,058,240	333,802,804	33,255,436	110.0	103,411,340	0.0
6-30-04	12-31-02	357,836,531	399,476,922	(41,640,391)	89.6	103,802,756	40.1

Supplementary Information

Hurley Medical Center
Consolidating Balance Sheet
June 30, 2004
With Comparative Totals for June 30, 2003

Assets	Hurley Medical Center	Hurley Health Services	Eliminations for Consolidation
Current assets:			
Cash and cash equivalents	\$ 30,010,343	\$ 3,148,097	\$ -
Patient accounts receivable, net	55,855,414	447,549	(400,875)
Other receivables	7,302,034	598,363	-
Inventories	3,222,448	-	-
Prepaid expenses and other	2,253,879	876,380	-
Assets limited as to use	3,153,535	-	-
Total current assets	<u>101,797,653</u>	<u>5,070,389</u>	<u>(400,875)</u>
Assets limited as to use:			
By the Board	45,206,388	-	-
Under bond indenture agreement - held by trustee	17,342,320	-	-
Restricted	330,589	-	-
Total assets limited as to use	<u>62,879,297</u>	<u>-</u>	<u>-</u>
Less assets limited as to use that are required for current liabilities	<u>(3,153,535)</u>	<u>-</u>	<u>-</u>
Noncurrent assets whose use is limited	<u>59,725,762</u>	<u>-</u>	<u>-</u>
Other assets:			
Deferred reimbursement and defeasance loss	1,169,612	-	-
Bond issuance costs, net	773,391	-	-
Investment in joint ventures	4,496,452	1,764,536	-
Investment in subsidiary	7,165,475	-	(7,165,475)
Subsidiary goodwill, and other	-	182,264	-
Total other assets	<u>13,604,930</u>	<u>1,946,800</u>	<u>(7,165,475)</u>
Property, plant and equipment, net	<u>60,209,355</u>	<u>1,670,841</u>	<u>-</u>
	<u>\$ 235,337,700</u>	<u>\$ 8,688,030</u>	<u>\$ (7,566,350)</u>

	2004	2003
\$	33,158,440	\$ 39,930,107
	55,902,088	66,279,699
	7,900,397	11,967,288
	3,222,448	3,255,819
	3,130,259	3,147,921
	3,153,535	2,572,387
	<u>106,467,167</u>	<u>127,153,221</u>
	45,206,388	12,255,486
	17,342,320	23,357,753
	330,589	333,290
	<u>62,879,297</u>	<u>35,946,529</u>
	(3,153,535)	(2,572,387)
	<u>59,725,762</u>	<u>33,374,142</u>
	1,169,612	1,335,632
	773,391	836,706
	6,260,988	5,115,716
	-	-
	<u>182,264</u>	<u>228,390</u>
	<u>8,386,255</u>	<u>7,516,444</u>
	<u>61,880,196</u>	<u>66,327,700</u>
\$	<u>236,459,380</u>	\$ <u>234,371,507</u>

(continued)

Hurley Medical Center
Consolidating Balance Sheet (continued)
June 30, 2004
With Comparative Totals for June 30, 2003

	Hurley Medical Center	Hurley Health Services	Eliminations for Consolidation
Liabilities and Fund Net Assets			
Current liabilities:			
Accounts payable and taxes withheld	\$ 14,711,125	\$ 365,162	\$ (400,875)
Current portion of long-term debt	3,407,320	-	-
Accrued expenses	32,922,825	1,157,393	-
Total current liabilities	51,041,270	1,522,555	(400,875)
Accrued expenses	17,201,050	-	-
Deferred defeasance gain	-	-	-
Lease obligations, net of current portion	4,490,805	-	-
Long-term debt, net of current portion	68,131,939	-	-
Total liabilities	140,865,064	1,522,555	(400,875)
Fund net assets:			
Invested in capital assets, net of related debt	22,109,685	-	-
Unrestricted	69,256,426	7,165,475	(7,165,475)
Restricted	3,106,525	-	-
Total fund net assets	94,472,636	7,165,475	(7,165,475)
	<u>\$ 235,337,700</u>	<u>\$ 8,688,030</u>	<u>\$ (7,566,350)</u>

2004	2003
\$ 14,675,412	\$ 16,746,094
3,407,320	3,184,247
34,080,218	28,975,317
52,162,950	48,905,658
17,201,050	17,902,711
-	-
4,490,805	5,935,238
68,131,939	69,887,877
141,986,744	142,631,484
22,109,685	20,441,358
69,256,426	67,595,434
3,106,525	3,703,231
94,472,636	91,740,023
\$ 236,459,380	\$ 234,371,507

Hurley Medical Center
Consolidating Statement of Revenues and Expenses - Unrestricted Funds
For the Year Ended June 30, 2004
With Comparative Totals for the Year Ended June 30, 2003

	Hurley Medical Center	Hurley Health Services	Eliminations for Consolidation
Net patient service revenues	\$ 287,836,153	\$ 5,801,099	\$ -
Other operating revenues	26,402,220	16,432,522	(15,663,652)
Gain on sale of renal program	-	-	-
Total operating revenues	314,238,373	22,233,621	(15,663,652)
Operating expenses:			
Salaries and wages	122,217,394	14,329,627	-
Professional services	31,380,465	45,513	(11,394,101)
Payroll taxes and fringes	33,444,426	2,564,389	-
Supplies	36,215,070	-	-
Purchased services and other	44,811,543	5,163,146	(498,416)
Depreciation and amortization expense	11,056,449	222,922	-
Interest expense	4,969,907	-	-
Impairment loss of Medicaid HMO receivables	-	-	-
Provision for uncollectible accounts	26,964,785	-	-
Total operating expenses	311,060,039	22,325,597	(11,892,517)
Operating profit (loss)	3,178,334	(91,976)	(3,771,135)
Non-operating revenues (expenses):			
Investment income and unrestricted donations	928,769	25,937	-
Management fees to PHO and joint venture income (expense)	(1,672,618)	-	3,771,135
Assets released from restrictions for the purchase of plant and equipment	960,873	-	-
Total non-operating revenues (expenses)	217,024	25,937	3,771,135
Excess (deficiency) of revenues over expenses before other activity	3,395,358	(66,039)	-
Other - subsidiary activity:			
Decrease in investment in subsidiary	(66,039)	-	66,039
Excess (deficiency) of revenues over expenses	\$ 3,329,319	\$ (66,039)	\$ 66,039

2004	2003
\$ 293,637,252	\$ 301,939,155
27,171,090	24,892,450
-	13,835,320
320,808,342	340,666,925
136,547,021	134,647,728
20,031,877	18,852,407
36,008,815	35,080,394
36,215,070	38,903,343
49,476,273	55,754,769
11,279,371	12,339,077
4,969,907	3,584,412
-	4,845,445
26,964,785	28,475,445
321,493,119	332,483,020
(684,777)	8,183,905
954,706	1,604,614
2,098,517	486,099
960,873	2,147,120
4,014,096	4,237,833
3,329,319	12,421,738
-	-
\$ 3,329,319	\$ 12,421,738

**Hurley Medical Center
Consolidating Statements of Changes in
Fund Net Assets - Unrestricted Funds
For the Years Ended June 30, 2004 and 2003**

	Hurley Medical Center General Fund	Subsidiary- Hurley Health Services	Elimination for Consolidation	Consolidating
Balance at June 30, 2002	\$ 75,615,054	\$ 6,644,607	\$ (6,644,607)	\$ 75,615,054
Excess of revenues over expenses	12,421,738	386,907	(386,907)	12,421,738
Balance at June 30, 2003	88,036,792	7,031,514	(7,031,514)	88,036,792
Capital contributed	-	200,000	(200,000)	-
Excess (deficiency) of revenues over expenses	3,329,319	(66,039)	66,039	3,329,319
Balance at June 30, 2004	<u>\$ 91,366,111</u>	<u>\$ 7,165,475</u>	<u>\$ (7,165,475)</u>	<u>\$ 91,366,111</u>

Hurley Medical Center
Consolidating Statement of Cash Flows
For the Year Ended June 30, 2004
With Comparative Totals for the Year Ended June 30, 2003

	2004	
	Hurley Medical Center	Hurley Hurley Services
Cash flows from operating activities and gains and losses:		
Receipts from patient and insurance companies	\$ 325,901,016	\$ 22,762,886
Payments to vendors	(173,445,381)	(7,801,888)
Payments to employees	(122,217,394)	(14,329,627)
Net cash provided by operating activities	30,238,241	631,371
Cash flows from investing activities:		
Distributions from joint ventures	2,675,000	46,011
Investment in Joint Venture	(1,742,000)	-
Investment in Subsidiary	(200,000)	200,000
Purchases of assets whose use is limited	(26,996,508)	-
Sale of stock certificates	-	(1,500)
Payments on notes receivable	-	24,500
Interest on investments	972,236	10,966
Net cash provided by investing activities	(25,291,272)	279,977
Cash flows from non-capital financing activities:		
Net proceeds from contributions restricted for specific expenditures	1,424,991	-
Management fees to PHO and joint venture income (expense)	(3,751,595)	-
Net cash provided by (used in) non-capital financing activities	(2,326,604)	-
Cash flows from financing activities:		
Proceeds from note payable and capital lease	-	-
Repayment of long-term debt and capital lease obligations	(3,196,359)	-
Purchase of property and equipment and software	(7,270,302)	(14,295)
Proceeds from sale of assets	139,836	37,739
Net cash provided by (used in) financing activities	(10,326,825)	23,444
Net increase (decrease) in cash and cash equivalents	(7,706,460)	934,792
Cash and cash equivalents at beginning of year	37,716,803	2,213,305
Cash and cash equivalents at end of year	\$ 30,010,343	\$ 3,148,097

2004		
Elimination for Consolidation	Total	2003
\$(15,663,652)	\$ 333,000,250	\$ 338,406,004
11,892,517	(169,354,752)	(186,261,063)
-	(136,547,021)	(134,647,728)
(3,771,135)	27,098,477	17,497,213
-	2,721,011	1,765,000
-	(1,742,000)	-
-	-	-
-	(26,996,508)	(543,809)
-	(1,500)	7,500
-	24,500	(23,279)
-	983,202	1,174,985
-	(25,011,295)	2,380,397
-	1,424,991	2,637,558
3,771,135	19,540	(182,403)
3,771,135	1,444,531	2,455,155
-	-	33,351,804
-	(3,196,359)	(30,453,292)
-	(7,284,597)	(8,005,046)
-	177,575	11,960,609
-	(10,303,381)	6,854,075
-	(6,771,668)	29,186,840
-	39,930,108	10,743,267
\$ - 0 -	\$ 33,158,440	\$ 39,930,107

(continued)

Hurley Medical Center
Consolidating Statement of Cash Flows (continued)
For the Year Ended June 30, 2004
With Comparative Totals for the Year Ended June 30, 2003

	2004	
	Hurley Medical Center	Hurley Hurley Services
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:		
Operating income (loss)	\$ 3,178,334	\$ (91,976)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities and gains and losses:		
Depreciation and amortization	11,056,449	222,922
Amortization of bond discounts, issuance costs, and other deferred charges	229,335	-
Amortization of deferred defeasance gain	219,061	-
(Gain) loss on disposal of equipment	292,443	-
Contributions released from restrictions	(1,104,291)	-
Changes in operating assets and liabilities:		
Patient and other accounts receivable	12,703,194	529,265
Inventories	33,371	-
Prepaid expenses and other	132,319	(51,213)
Interest receivable on assets whose use is limited	63,740	-
Accounts payable and taxes withheld	(967,182)	143,326
Accrued expenses	4,401,468	(120,953)
Net cash provided by operating activities and gains and losses	<u>\$ 30,238,241</u>	<u>\$ 631,371</u>

Supplemental disclosures of cash flow information:

Cash paid for interest in 2004 and 2003, was \$4,091,502 and \$3,583,732 respectively.

Non-cash transactions:

The Medical Center recorded an decrease in the investment in subsidiary in the amount of \$176,876 in 2004 and a increase in the amount of \$386,907 for 2003.

The Medical Center recorded an increase in the investment in joint ventures in the amount of \$1,145,977 and \$688,503 for 2004 and 2003, respectively.

The Medical Center sold its renal program during 2003, \$3 million of the proceeds from this sale was in the form of a short term receivable.

2004		2003
Elimination for Consolidation	Total	
\$ (3,771,135)	\$ (684,777)	\$ 8,183,905
-	11,279,371	12,339,077
-	229,335	792,230
-	219,061	38,078
-	292,443	(13,746,513)
-	(1,104,291)	(434,321)
-	13,232,459	(1,890,340)
-	33,371	615,575
-	81,106	404,626
-	63,740	63,740
-	(823,856)	544,453
-	4,280,515	10,586,703
\$ (3,771,135)	\$ 27,098,477	\$ 17,497,213

October 14, 2004

To the Board of Hospital Managers
Hurley Medical Center
Flint, Michigan

We have audited the consolidated financial statements of Hurley Medical Center (the Medical Center) and its subsidiary for the year ended June 30, 2004, and have issued our report thereon dated October 1, 2004. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Generally Accepted Auditing Standards

As stated in our engagement letter dated April 19, 2004, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the consolidated financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, fraud, or other illegal acts may exist and not be detected by us.

In planning and performing our audit of the consolidated financial statements of the Medical Center for the year ended June 30, 2004, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure. Accordingly, we do not express such an opinion.

During the audit, we became aware of certain matters that, while not involving reportable conditions in internal accounting control, are opportunities for strengthening internal controls and operating efficiency or are potential improvements to financial policies. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Medical Center's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. This letter summarizes the status of the comments and suggestions that have yet to be resolved from the June 30, 2002 and February 28, 2003 audits, the status of all comments and suggestions from the June 30, 2003 audit, and our comments and suggestions regarding those matters from the current year. This letter does not affect our report dated October 1, 2004, on the consolidated financial statements of Hurley Medical Center.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with the various personnel of the Medical Center, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Reimbursement Staff (June 30, 2002)

The reimbursement staff has had two employees retire and has experienced other employee turnover in 2001 and 2002. The Medical Center has temporarily staffed the reimbursement department with several contractual employees and other positions remained open. It is critical that the Medical Center hire and retain permanent employees in this area due to the technical nature of the reimbursement function and the fact that a sense of history with the Medical Center is important with resolving ongoing audits and appeals.

June 30, 2003 status:

Management has begun the recruiting process to hire a permanent employee for the reimbursement department and has identified a viable prospect.

June 30, 2004 status:

Management has not yet been able to find a qualified employee to fill this position and continues to recruit a permanent employee for the reimbursement department.

Final Review of General Ledger Accounts (June 30, 2002)

As in the prior years, the closeout process does not allow for an independent review of the account balances by an immediate supervisor or allow the accountants to perform a final review of the general ledger balances to ensure that any last minute adjustments were properly considered. Based on the adjustments identified during the 2002 audit, there were number of balance sheet accounts that had adjustments posted to the accounts after the accountant had completed the year end analysis and reconciliation. We are recommending that management allow for additional time for managers to review the general ledger accounts in comparison to the final audit schedules before the numbers are released to the finance committee. This final review process should improve the accuracy of the final close-out amounts and will ensure that all audit schedules are timely submitted.

June 30, 2003 status:

Procedures to review the general ledger before monthly statements are issued have been put in place. At the close of every month, a finance supervisor looks at the balance sheet to check that the balances in these accounts appear reasonable, also the managers review the expense accounts for reasonableness and make adjustments. During the closing process, managers also receive preliminary reports which they review for reasonableness before the numbers are finalized.

While reasonableness checks are done at month end, we believe there is still a need for a review of the general ledger accounts in comparison to the final audit schedules before the numbers are released to the finance committee.

June 30, 2004 status:

There is no change to this comment.

Contractual Allowances (February 28, 2003)

Several third party payers such as CMH, Health Plus of Michigan, and Health Plus Partners have multiple (six or seven) unsettled years. The general ledger tracks three elements of the third party payer process separately – charges, contractual allowances and payments. It is difficult to assess the settlement position of the Medical Center based on the different elements being recorded in different accounts and by having multiple years unsettled at any given time. This could result in the Medical Center can having a significant settlement from a payer and management not realizing the amount of the settlement. The settlement can impact future cash levels either negatively or positively. We recommend that management analyze the settlements accounts for all open years to determine the settlement amounts and that the open years be settled as soon as possible to enhance management's ability to manage the cash flow of the Medical Center.

We noted that the credit worthiness of The Wellness Plan (TWP) still needs to be monitored.

June 30, 2003 status:

We noted during the 2003 audit that the CMH payer is current and that the Health Plus of Michigan and Health Plus Partners still have unsettled years from 1997 to present. In September 2003, management initiated communication with Health Plus Partners to resolve the outstanding years.

The Wellness Plan is currently in bankruptcy and has been taken over by the state. The state has said that the Office of Financial and Insurance Services will pay provider claims for services provided on or after July 1, 2003. Reimbursement for services with date of service prior to July 1, 2003 will be determined by the Office of Financial and Insurance Service after reviewing The Wellness Plan's financial condition. The Medical Center has booked a reserve on this settlement of 50% of the outstanding settlements. There have been negotiations between the state and a potential buyer for TWP. Management has monitored this issue closely and estimated for a potential loss as appropriate.

June 30, 2004 status:

As of the 2004 audit, Health Plus of Michigan and Health Plus Partners still have unsettled years from 1997 to present.

During 2004, The Wellness Plan members in Genesee County area were sold to McLaren Health Plan. Since the sale, The Wellness Plan has been paying current claims. Management has received correspondence from The Wellness Plan that old outstanding claims will also be paid at Medicaid rates. In light of this, the Medical Center reduced the amount recorded for the impairment loss at June 30, 2004 to 10% of what was recorded for the impairment loss at June 30, 2003.

Bank Reconciliations (February 28, 2003)

It was noted during the interim review at January 31, 2003, that the monthly interim financial statements included a reclassification journal entry of the cash balance based on the bank balance at month end and a calculated outstanding check amount. Upon further investigation, it was noted that the bank reconciliation was not being completed monthly, rather only at year end. The monthly procedures included the preparation of an outstanding check listing; however the depository account was not reconciled to the general ledger account and the payroll activity was not reviewed monthly.

Strong internal accounting controls include monthly bank reconciliations to ensure the accuracy of the ending balances. Furthermore, by reviewing the bank reconciliation monthly, the task would not be as significant for the year end close which should improve staff efficiencies.

June 30, 2003 status:

We noted that monthly bank reconciliations are still not being performed in detail as noted above. This responsibility is currently assigned to the reimbursement staff which has been short two full time people for almost a year. Management needs to evaluate whether it is appropriate to assign responsibility to the reimbursement staff and what the appropriate time table is to complete the assignment (i.e. before the interim financial statements are issued or by month end.)

June 30, 2004 status:

Although bank statements are not being completed regularly by employees in the reimbursement department, the reconciliations are generally being done three or four months after the close of the month being reconciled. Management is currently working on completing the reconciliation in time for the close of the month being reconciled.

Computer File Management (February 28, 2003)

During our audit, comments about the computer files were noted as follows:

- Currently files are saved under the user directory; therefore the author of the file must be known to be efficiently located
- Some files are saved in several different directories rather than being effectively indexed and referenced with file name footers
- Some staff members save to the hard drive or diskettes instead of the network

These comments indicate that computer files are not handled consistently and that the structure may not be efficient. We recommend that a departmental wide directory structure be developed for the shared network drive and that existing files be converted to this new format. There should also be a file management policy developed for employees to help guide employees when saving files to the network directory. This will make the saved files universal and easier to find by new employees or other employees needing to retrieve a file prepared by another associate.

June 30, 2003 status:

There is no change to this comment.

June 30, 2004 status:

The current focus of resolving this issue has been getting finance employees all on the same server. This was accomplished during the fiscal year and now the focus will be having employees begin to save their documents with a prescribed format to the network directory. Areas, such as reimbursement have already begun saving their files to the network directory.

Accounts Receivable (February 28, 2003)

During review of accounts receivable, it was discovered there were significant credit balances within the accounts receivable aging systems. Based on inquiry it was noted that only the Medicare credit balances are reviewed on a regular basis due to a compliance requirement. A sample of the credit balances were reviewed which resulted in a significant audit adjustment. Without an effective accounts receivable credit balance policy, the financial statement could be misstated by improperly netting liabilities with the accounts receivable whereby understating the assets and liabilities, which correspondingly impacts the bad debt allowance and contractual allowance calculations.

We recommend the Medical Center establish a policy on handling credit balances within the aging systems of accounts receivable for both the main accounts receivable system (SMS) and the physician billing system (POLCI). A regular review either quarterly or semi-annually will identify the credit amounts and these amounts can be properly reclassified as a liability or identify issues with contractual posting errors.

June 30, 2003 status:

Management has been researching the credit balances within accounts receivable and, as a result, the overall net credit balances have decreased approximately \$2.5 million between April 30th and June 30th. A total of \$7.5 million of credit balances remain. We believe it would be beneficial to establish a formal policy that is communicated to the staff to establish procedures and set expectations regarding this issue relative to 1) a timetable for the clean up of the old balances and 2) any new balances that are created in the future.

June 30, 2004 status:

During 2004, management implemented a formal credit balance policy on currently occurring credit balances for Inpatient and Outpatient receivables. The policy is that when a credit balance is generated, it is identified and procedures for resolution are begun the next working day. The credit balances generated prior to the June 30, 2004 fiscal year are still an issue that needs to be resolved in the Inpatient, Outpatient, and Physician Billing areas.

Internal Financial Statement Process (February 28, 2003)

During the financial statement write-up process three items were noted as follows:

- The current MSA financial summary reports (GL-F-1A and GL-F-1B) do not balance. The variance relates to the fund balance accounts not considering the current profit.
- The current monthly income when added to the prior month year to date income does not tie to the current year to date income. These variances have been adjusted to the balance sheet through the retention account of approximately \$150,000.
- The new balance sheet accounts are not pointed to a financial statement line item and are manually adjusted every month. After the year end the balance sheet accounts are properly pointed to a specific financial statement line item.

We recommend that the information systems department review the MSA roll-up accounts and consult with the Finance department to ensure that all revenue and expense accounts are properly pointed to a financial statement line and investigate the variance. We also recommend when new accounts are added a financial statement line item is assigned.

June 30, 2004 and 2003 status:

There is no change to this comment.

Interim Budgets (February 28, 2003)

During interim procedures at January 31, 2003, it was noted that the Medical Center's revenue and contractual allowance model is not updated on an interim basis. The model considers several reimbursement variables such as census, case mix, payer mix and current reimbursement rates. We recommend that this model be updated two to three times a year to consider the impact the reimbursement variables have on the Medical Centers net patient service revenue. This information can be considered with the actual expenditures to assist management with operational decisions.

June 30, 2003 status:

Management has not implemented this recommendation due to the timing of the completion of the February audit and the June close out taking place within a short time period. Management intends on evaluating this matter in the fall of 2003.

June 30, 2004 status:

Management is still only updating the contractual allowance model annually, but has a goal of beginning to update the model on a quarterly basis beginning in fiscal year 2005.

TMS Payroll System (June 30, 2003)

Under the new TMS payroll system, employees do not see the time that has been submitted for them prior to getting their check. If there is an error, the employee then has to report it to the Payroll department, which investigates the discrepancy and then corrects the error on a future check. We recommend that a system be put in place in which the employee is required to approve their time before the supervisor approves to ensure that employees agree with the time entered for them and any discrepancies are resolved before the payroll check is issued.

It was also noted that the Payroll department spends many hours each payroll process correcting timesheets manually in the new TMS system. TMS support should be consulted with to resolve the many issues requiring manual entry adjustments by the users and the Payroll department every pay period so that the Payroll department can be freed up to take on more cost centers being added to the TMS system.

June 30, 2004 status:

During 2004, new time clocks were installed which allowed employees to view their summary of benefit time available. Employees are required to swipe the cards in and out daily. The employee can also see the TMS data in the system for that pay period. Any benefit time for the pay period cannot be seen in the system, but is added subsequently by the supervisor based on the accrued leave forms.

Management has worked with TMS during the year to try to resolve the need for time consuming manual entry during each payroll process. Through discussions with TMS personnel, management is satisfied that they are using the system to its full capability. Under the current system limitations, situations such as employees with different position codes and employees receiving incentive pay will still require manual adjustments.

Authorized Check Signers (June 30, 2003)

Based on a review of the check signature cards it was noted that a general update of the authorized signers needs to be conducted. We recommend that this documentation be updated at least annually.

Our understanding is that the signature cards were updated in October 2003.

June 30, 2004 status:

During the March 18, 2004 Finance/Facilities Committee meeting, authorized check signers were approved by the board and signature cards were filed with each bank with which Hurley does business.

Blue Cross Control Account Adjustment (June 30, 2003)

During the audit it was noted that again there is a large year end adjustment, approximately 3.8 million, to the Blue Cross Control Account. It has been determined that the expense estimates that affect this account only consider the outside insurance cost (i.e. people times insurance rates). The full cost to the Medical Center has not been covered by the expense estimates for some time. The offset to the year end adjustment is partially booked to the contractual allowance line item and to the miscellaneous cost center (9980). Since the contractual allowance line is not budgeted closely the impact of the year end adjustment has not been a concern by departmental officials.

We recommend that the estimates that are charged to the departments be adjusted to more accurately reflect the actual costs. The estimate should be compared to actual costs during the year and adjusted as necessary. We understand that the Human Resources department made a change in fiscal year 2004 so that the benefit year now matches the fiscal year of the Medical Center. This should correct the adjustment relating to the employee portion. Further assistance from the Human Resource department may be necessary to resolve the rate estimate variances.

June 30, 2004 status:

The issue has been resolved. Management has reviewed the system transactions and has determined that the balance is a result of the way charges are cleared to the contractual allowance account and that an adjustment will be required annually as a part of the fiscal year closeout to adjust the account.

June 30, 2004 Comments and Recommendations:

Malpractice Insurance

The malpractice excess coverage insurance carrier has changed twice over the past three years. The carrier changed as of July 1, 2002 because the existing carrier no longer offered malpractice excess insurance policies.

At that time no tail coverage was purchased because it was not economically prudent. This means that cases in which the incident occurred prior to July 1, 2002 and was not reported until after July 1, 2002 are not covered by a malpractice insurance policy. The carrier was changed again as of July 1, 2004. When the carrier was changed effective July 1, 2004, tail coverage was purchased to cover claims retroactive back to July 1, 2002 (the maximum coverage available to the Medical Center). There are many malpractice cases for which no excess coverage exists. The cases are in various stages of the settlement or litigation process. The current accrual for malpractice claims is based on the combined actuarial estimate of "incurred but not reported" claims plus an estimate of the liability for the existing claims that an unfavorable outcome is "probable" per the Medical Center's legal counsel. The actual results of those claims could differ from estimates and could possibly have a significant liability that the Medical Center would have to fund "out of pocket".

We recommend that legal counsel and management continue to monitor the trends and results of the cases with no insurance coverage to determine if accrued liabilities are adequate.

Outstanding Medicare Settlements

Medicare has several outstanding settlement years extending as far back as fiscal year 1993. We recommend that the Medical Center continue efforts to resolve these old settlement years with United Governmental Services (UGS) as soon as possible so they can be closed on the Medical Center's books. Having multiple old outstanding settlements leaves UGS free to revisit issues that had been previously resolved and increases the probability that new staff from either the Medical Center or UGS will be introduced who are not familiar with the issues in the unsettled years.

Impact of New GASB Regarding Retiree Health Care Liabilities

The Governmental Accounting Standards Board issued a new pronouncement, GASB Statement No. 45, *"Accounting and Financial Reporting by Employees for Post-employment Benefits Other Than Pensions"* that will require governmental entities to reflect the estimated liability for retiree health care costs (that is not funded through a pension trust) on the balance sheet of the governmental unit. The liability is required to be actuarially calculated and to cover the estimated cost of the benefit over a period approximating the employees' years of service. Currently, the Medical Center pays for a portion or all of retiree health care premiums for various retiree groups. Generally, this liability is paid for on a pay-as-you-go basis and the new pronouncement will require the estimated future costs to be accrued currently. The pronouncement is effective for the Medical Center for fiscal years beginning after December 15, 2006. While the implementation is a few years away we want to make the management and the Board aware of this accounting standard so that preparations can be made to implement the standard and to prepare for its impact, if any.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by Hurley Medical Center are described in Note 1 to the consolidated financial statements. No new accounting policies were adopted.

Accounting Estimates

Accounting estimates are an integral part of the consolidated financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about

future events. Certain accounting estimates are particularly sensitive because of their significance to the consolidated financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were the estimated contractual allowances, the allowance for doubtful accounts, the impairment loss on Medicaid HMO accounts receivable, the useful lives of plant and equipment, and the accrued liabilities for the self insurance malpractice trust.

Management's estimates for each of the items listed are based on past history and a review of the current factors affecting the underlying transactions. We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the consolidated financial statements that, in our judgment, may not have been detected except through our auditing procedures.

An audit adjustment may or may not indicate matters that could have a significant effect on the Medical Center's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Medical Center, either individually or in the aggregate, indicate matters that could have a significant effect on the Medical Center's financial reporting process.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the general purpose financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the government unit's general purpose financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Hurley Medical Center's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Board of Hospital Managers
Hurley Medical Center
October 14, 2004
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Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

This information is intended solely for the use of the Board of Managers and management of Hurley Medical Center and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

BKR Dupuis & Ryden

Certified Public Accountants
Flint Office